

TENNESSEE GENERAL ASSEMBLY  
FISCAL REVIEW COMMITTEE



**FISCAL NOTE**

**SB 59 - HB 423**

March 16, 2015

**SUMMARY OF BILL:** Changes the statutory apportionment formula, for tax years beginning on or after January 1, 2016, used to calculate the portion of net earnings and net worth apportioned to Tennessee for franchise and excise tax purposes from a three-factor formula to a single-sales-factor formula. Implements the market-based sourcing of sales, other than sales of tangible personal property, instead of cost-of-performance sourcing, by establishing that such sales are in this state if the receipts are derived from customers within this state or if the receipts are otherwise attributable to this state's marketplace.

**ESTIMATED FISCAL IMPACT:**

**Decrease State Revenue – Net Impact – \$109,391,600/FY15-16**  
**\$13,012,800/FY16-17**  
**\$27,897,600/FY17-18**  
**\$59,330,300/FY18-19 and Subsequent Years**

**Increase State Expenditures – \$110,600/FY15-16**

**Other Fiscal Impact – Secondary economic impacts may occur as a result of this bill. Due to multiple unknown factors, fiscal impacts directly attributable to such secondary impacts cannot be quantified with reasonable certainty.**

Assumptions relative to the Franchise and Excise Apportionment Formula:

- Under current law, a taxpayer's net earnings and net worth are apportioned to this state using a three-factor formula that consider the taxpayer's sales, property and payroll, with the sales factor double-weighted so that the property and payroll represent 50 percent of the apportionment factor and the sales representing the remaining 50 percent.
- The proposed legislation will, for tax years beginning on or after January 1, 2016, eliminate the property and payroll factors and implement the single-sales-factor formula, where net earnings and net worth are apportioned to this state based on the taxpayer's Tennessee sales as a proportion of its total sales in the United States.
- The estimate of the fiscal impact of this bill is based on the Department of Revenue's static analysis of franchise and excise tax returns for tax periods ending in 2013. A taxpayer's tax liability will be directly impacted by the change to the single-sales-factor formula, unless 100 percent of the taxpayer's sales, property and payroll are located in Tennessee. Further, the taxpayer's tax liability will also be dependent on several other

factors, including the amount of loss carryover from prior years and the amount of available tax credits.

- In general, and not accounting for loss carryovers and tax credits, the change to a single-sales-factor formula will increase the tax liability for multi-state taxpayers where the sales factor is greater than the property and payroll factors, and will decrease the tax liability for multi-state taxpayers where the sales factor is greater than the property and payroll factors.
- The change to a single-sales-factor formula will not have an immediate impact on the amount owed to the state for taxpayers who offset 100 percent of the tax liability as a result of loss carryovers and tax credits, particularly industrial machinery and jobs tax credits. However, since the tax base for these taxpayers, who typically have relatively larger property and payroll factors and relatively smaller sales factors, will be lower as a result of the change to a single-sales-factor formula, they will have more credits to carryover to future years.
- The Department estimates that the change to a single-sales-factor formula will decrease franchise and excise tax collections by 3.91 percent, or approximately \$74,649,720, per year. The Department's static analysis of franchise and excise tax returns estimates that, of 36,459 taxpayers who apportion their net earnings and net worth using the statutory formula amended by this bill, 15,533 will experience an increase in their tax liability of approximately \$201,729,208 in total, 8,171 will experience a decrease in their tax liability of approximately \$276,387,928 in total, and 12,754 will not experience a significant impact on their tax liability.
- Franchise and excise taxpayers are required to make estimated payments if their combined tax liability for the current year exceeds \$5,000. Such estimated payments are due on the 15<sup>th</sup> day of the fourth, sixth, and ninth months of the current tax year, and on the 15<sup>th</sup> day of the first month of the succeeding year. Each estimated payment is required to be the lesser of: 25 percent of 100 percent of the combined franchise and excise tax shown on the tax return for the preceding year; or 25 percent of the combined liability for the current year.
- Since the estimated payments of taxpayers with an increased liability are only required to be 25 percent of the combined tax from the preceding year, it is assumed that these taxpayers will not increase their estimated payment in the first year. However, since the estimated payments for taxpayers with a decreased liability are only required to be 25 percent of the combined tax from the current year, it is assumed that these taxpayers will decrease their estimated payments in the first year.
- The tax years of the tax returns were used to estimate the impact of the timing of the estimated payments on tax collections.
- For the FY15-16, the decrease in state revenue will be greater than in subsequent years because the lower estimated tax payments by taxpayers with decreases in liability are not offset by higher estimated payments by taxpayers with increases in liability. However, taxpayers with increases in liability will have to make a one-time payment when the return is due in April 2017, in addition to the higher payments for the tax year beginning January 2017, thus mitigating the impact in FY16-17 and FY17-18.
- The resulting decreases in state revenue are estimated to be: \$109,391,638 in FY15-16; \$26,417,322 in FY16-17; \$41,302,112 in FY17-18; and \$74,649,720 in FY18-19 and subsequent years.

#### Assumptions relative to Market-Based Sourcing:

- The proposed legislation will implement the market-based sourcing principle, instead of cost-of-performance sourcing method, for sales other than sales of tangible personal property, by establishing that such sales are in Tennessee if the receipts are derived from customers within Tennessee or are otherwise attributable to Tennessee's marketplace.
- Under the cost-of-performance method, sales are sourced to Tennessee if the earnings-producing activity is performed in Tennessee, or both in and out of the state and a greater proportion of the earnings producing activity is performed in Tennessee than in any other state, based on costs of performance.
- Based on the analysis of estimates of the impact of market-based sourcing in Pennsylvania and Massachusetts, the Department estimates that franchise and excise tax collections will increase by approximately 0.515 percent, or \$10,212,965, per year, based on the current statutory apportionment formula. Since this bill will change the formula to a single-sales-factor, this estimate is increased by 50 percent to account for the fact that companies that would be sourcing sales to Tennessee under a market-based sourcing rule are companies with little or no property or payroll in Tennessee.
- The resulting recurring increase in state revenue is estimated to be \$15,319,448 (\$10,212,965 x 150%).
- Because the new taxpayers are based out-of-state, the Department anticipates a lag in full compliance. As a result, the compliance is anticipated to be 50 percent in FY16-17, 75 percent in FY17-18, and 100 percent in FY18-19 and subsequent years.
- Taking into account tax return due dates, the increase in state revenue is estimated to be: \$13,404,516 in FY16-17; \$13,404,516 in FY17-18; and \$15,319,448 in FY18-19 and subsequent years.

#### Assumptions relative to Total Revenue Impacts and State Expenditures:

- The net decrease in state revenue as a result of the proposed legislation is estimated to be \$109,391,638 in FY15-16; \$13,012,806 (\$26,417,322 - \$13,404,516) in FY16-17; \$27,897,596 (\$41,302,112 - \$13,404,516) in FY17-18; and \$59,330,272 (\$74,649,720 - \$15,319,448) in FY18-19 and subsequent years.
- There could be subsequent impacts on state and local government revenue and expenditures as a result of secondary economic impacts prompted by the passage of this bill. Due to multiple unknown factors, the fiscal impacts attributable to such secondary impacts cannot be quantified with reasonable certainty.
- The Department reports that there would be a one-time increase in expenditures to the Department of \$110,600 in FY15-16, to accomplish all the technology changes required by this bill. Such changes include, but are not limited to, development of new versions of the franchise and excise tax forms, new versions of the keying programs, reformat programs, debit and credit memos, and communication and testing hours in conjunction with the vendors.

#### **CERTIFICATION:**

The information contained herein is true and correct to the best of my knowledge.

A handwritten signature in dark ink, reading "Jeffrey L. Spalding". The signature is written in a cursive style with a large, stylized "J" and "S".

Jeffrey L. Spalding, Executive Director

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